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Avinash Kumar



Avinash Kumar has completed his Ph.D. in International Investment Law from the Dept. of Law & Governance, Central University of South Bihar. His research work is on "International Investment Agreement and State's right to regulate Foreign Investment." He qualified UGC-NET and has been selected for the prestigious ICSSR Doctoral Fellowship. He is an alumnus of the Faculty of Law, University of Delhi. Formerly he has been elected as Students Union President of Law Centre-1, University of Delhi. Moreover, he completed his LL.M. from the University of Delhi (2014-16), dissertation on "Cross-border Merger & Acquisition"; LL.B. from the University of Delhi (2011-14), and B.A. (Hons.) from Maharaja Agrasen College, University of Delhi. He has also obtained P.G. Diploma in IPR from the Indian Society of International Law, New Delhi. He has qualified UGC – NET examination and has been awarded ICSSR – Doctoral Fellowship. He has published six-plus articles and presented 9 plus papers in national and international seminars/conferences. He participated in several workshops on research methodology and teaching and learning.

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TAX EVASION AND THE GENERATION OF BLACK MONEY IN INDIAN ECONOMY: A CRITICAL ANALYSIS

AUTHORED BY - ASHISH PATHAK

RESEARCH SCHOLAR

UNIVERSITY OF LUCKNOW

ABSTRACT

Tax evasion and black money generation in any economy has its own repercussions not only for the citizens of that country but also for its economy. It not only creates difficulties in curbing inflation but also creates a sense of insecurity among taxpayers. Black Money can be defined as a money that is not reported to the Income- Tax authorities and the source of which is not legal. The main reason of black money generation in a country's economy is tax evasion on part of the citizens at large and also failure to file their Income Tax returns which creates a void in the taxing system where accurate and transparent information of transactions or earnings is not reported by a person (defaulter) to the Income Tax authorities. The study of this paper includes an analysis of laws that may help in tracing untaxed or black money back in the tax havens and also the steps taken by the Indian government to bring back the amount of black money stashed in tax haven nations like Switzerland, etc. The author has tried to formulate the reasons of generation of black money in an economy and its implications at large. The Research Questions focus on the need to have laws in India for combating tax evasion and the generation of black money in the economy and their impact on the current system. The researcher has followed the doctrinal (non-empirical) method of research and the Review of Literature includes an analysis of write ups of eminent authors and scholars.

Keywords: Black Money, Taxpayers, Economy, Laws, Doctrinal.

1. PRELUDE

The dignitaries involved in the framing of the Indian Constitution deliberately added principles related to security, human rights and welfare of the citizens in the Indian Constitution. Their zeal to give India a recognition on the world's map made them draft a constitution which talks about the rights and duties of the citizens parallelly.¹ Their dreams could have been fulfilled by including provisions related to collection of tax in the Indian Constitution because infrastructural development in any nation can be done only through money and for that tax collection was felt necessary.² Their desire for India having a good infrastructural set up comprising of hospitals, schools, roads, railway tracks, etc. made them create a potent system of tax collection by including provisions related to it in the Indian Constitution and citizens were asked to pay taxes as per their earning capacity. The highlighted statutory laws passed by the Parliament of India include The Income Tax Act³ of 1961 and CGST Act of 2017 regulating the modes of collection of taxes. The other laws and authorities related to the generation of black money and nabbing offenders include Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015, Fugitive Economic Offenders Act, 2018, Central Board of Direct Taxes, Central Board of Excise and Customs etc. In spite of these laws and regulations, people have taken advantage of the existing loopholes in the present taxing system and evaded their taxes on a large scale.⁴ If the implementation of the laws would have been perfect, and the authorities had performed their duties more effectively, the cases of tax evasion would have been minimum. It is important to note here that Tax Evasion is primarily responsible for the generation of black money in an economy and not Tax Avoidance. Tax Avoidance is when a person tries to exploit the gaps present in the legal system and somewhere reduces his tax liability. While tax evasion is illegal as it includes deliberate efforts or unwillingness on part of a person to pay his income tax or tell the real source of his income to the authorities and it is a kind of 'tax-theft'. This is a problem that creates a gap between *what has been obtained* and *what should have been obtained* by the government in form of taxes. There have been instances where people have hesitated in telling the exact source of Income to the Income Tax department prompting the latter to raid the premises of the former.⁵ These people collect money that goes unreported to the authorities and stash them in tax haven nations

¹ WWW. CONSTITUTIONOFINDIA.NET (Last visited May. 2, 2024) Read - Constitution of India

² India Const. art. 265

³ Income Tax Act, 1961, S. 4, Acts of Parliament (India)

⁴ "GST officials detect 14,597 tax evasion cases in Apr-Dec: Govt informs LS" 2024, Business Standard, February.

⁵ "Top 10 biggest Income Tax raid in India" 2024 Clear Tax, May 20, Biggest Income Tax Raid in India | Top 10 Biggest Income Tax Raid in India (cleartax.in)

thereby creating black money. Economic growth of a nation takes a severe hit due to these misdeeds of the defaulters because the money that has been taken away and deposited in the banks of tax haven nations could have been utilized for the benefit of the citizens of a nation. The governments could have constructed hospitals, schools, railway stations, bridges, and other infrastructure from the money that has not been reported to the authorities in India thereby depriving the citizens of facilities in spite of taxes been collected from them by the government. This creates a sense of frustration among the citizens as they fail to understand that even after paying high taxes to the government, why the country is lacking resources or infrastructural development. Tax havens⁶ like Swiss Banks, etc. often impose least amount of taxes on foreign citizens or companies. A developing country needs to utilize its maximum resources for coming in the league of developed nations and for this, transparent taxing system is a must. Undoubtedly, it is important to have a potent, acceptable and justified framework of tax collection chalking out the rules and regulations that can be a part of tax collection in a country like India. *The Standing Committee on Finance*, reports that the Government of India has signed Tax Treaties with 146 nations, advocating for Double Taxation Avoidance Agreements, etc. between the nations.⁷ The International Monetary Fund says that revenue loss (annual) to the Indian government is between \$200 billion and \$600 billion.⁸ This data is sufficient to give us an impression about the implications of the generation of black money in an economy. The issue of black money generation in an economy creates problems not only for the governments of a developing country but also the developed ones. Therefore, it becomes necessary to find out the reasons of the generation of black money in a developing country like India and the steps that can be taken to minimize the instances of tax evasion and thus black money generation.

2. BLACK MONEY- HOW IS IT GENERATED IN AN ECONOMY

Black Money, in any economy, is generated due to many reasons including weak policies of the government and its lackluster approach in nabbing tax defaulters. There are many other reasons as well like high tax rates, corrupt minds, etc. but fragile policies to deal with tax evaders is the most important of them. Let's try to understand the causes of black money

⁶ A Tax haven country has zero or very less tax rates and it does not share the information of the depositor with other nations.

⁷ 73rd Report, Standing Committee on Finance (2018-2019). <https://taxguru.in/income-tax/status-unaccounted-income-wealth-country-critical-analysis.html>. (24th June 2019)

⁸ Richard Mahapatra, Tax avoided by corporate groups can eradicate global poverty, *Down To Earth*, <https://www.downtoearth.org.in/blog/economy/tax-avoided-by-corporate-groups-can-eradicate-global-poverty-66243>, August 20, 2018

generation in a developing economy like India and the effect of the black money on its economy and the citizens living within the boundaries of the country because without understanding these two aspects of black money it would be difficult for a researcher to know about the complications of having untaxed money in a country. So, let's understand these problems one by one.

2.1 Insufficient steps on part of a government due to weak will power

For combating the problem of black money or tax evasion, it is very much necessary for a government to take strong steps for nabbing those who have willfully evaded their taxes and cheated the government. This requires strong laws and more importantly, their implementation in true letter and spirit. If the governments fail to address the issue of black money properly, people take advantage of this and tend to stash their untaxed money in foreign banks. Having said that, if a government doesn't take proper steps to bring back the money stashed by people in tax havens, or shows reluctance in prosecuting tax defaulters, it gives an impression to the people that they can get away by doing anything and they won't be prosecuted at all.

2.2 Corruption and its chain

Corruption in any nation destroys the roots of the economy of that nation because a corrupt person finds different ways to earn money that was not supposed to be earned by him. There have been many instances where government officials have been found to have a nexus with the tax defaulters and they have been accused of giving them undue advantage.⁹ The tax evaders promise to pay some amount to the government officials and in return, they give them clean chit. This series of corruption starting from the government officials creates a perception in the mind of the tax evader that he won't be caught or prosecuted because his case is not going to be highlighted due to the support he has from the officials. He makes a habit of doing this as he has a wide network of people who are involved in this process of hiding taxable income from the government. Many nations have dealt with the problem of corruption very strictly and have created a sense of honesty among their citizens and thereby reflecting negligible cases of corruption in these countries clearly mentioned by Corruption Perception Index report published by Transparency International in 2023.¹⁰ India should definitely take an example

⁹ Virendra Singh Ghunavat, Munish Chandra Pandey, Mastermind of Nirav Modi- PNB scam reveals how he helped carry out fraud transactions, 2022, India Today news, Apr. 11, <https://www.indiatoday.in/india/story/rs-11-400-crore-pnb-fraud-ed-may-attach-properties-of-nirav-modi-mehul-choksi-cbi-seals-brady-house-branch-1172622-2018-02-19>.

¹⁰ Corruption Perception Index.

from these nations and work on the loopholes that are present in its tax collection system. This may include scrutiny of the incomes of government officials twice a year by a body constituted by the government headed by the Comptroller and Auditor General of India.

2.3 Base Erosion and Profit Shifting

There are certain countries that offer low tax rates thereby inviting the companies to shift their business in their territory. The companies, sometimes pay less taxes or take advantage of the taxing system of a country. The companies having their businesses across the globe shift their profits or businesses in countries that demand less money in form of taxes due to their liberal policies. This disrupts the honest process of collecting tax by other nations.¹¹ This is known as Base Erosion and Profit Shifting.

2.3.1 Double Taxation Avoidance Agreement (DTAA)

India has entered into treaties with many other countries for the purposes of regulating taxes and DTAA is one of them. Section 90 of the Indian Income Tax Act, 1961 empowers the Central Government in India is empowered to make an arrangement (in form of an agreement) with another country to seek relief in respect of Income which has been doubly taxed or to finish double taxation of an individual or a company in a different nation thereby promoting mutual cooperation.¹² Double Taxation Avoidance Agreement (DTAA) helps a company to be taxed only in one country. A Treaty that helps an individual as well as a company to claim¹³. For e.g. a person who is a resident¹⁴ of India has moved to a different country for starting his business or to arrange means for his livelihood. His income is subject to the taxes decided by the government of that country. In this case, it would be difficult for this person to pay his taxes to the governments of that country as well as India and it becomes necessary for the two countries (India and the other nation) to come together and make certain rules for ensuring that the person is taxed only once and not twice as it will be difficult for him to pay taxes on his income in two different countries. The aim of DTAA is twofold. First to make it easier for a person or a company to pay taxes in one country and second to ensure investments and attract people for working in a country by making it entitle to collect taxes. However, there are some people who try to manipulate the terms and conditions of these treaties as well and we can

¹¹ <https://www.rauias.com/daily-current-affairs-for-upsc-ias/double-tax-avoidance-agreement-cairn-energy-upsc/>

¹² Mittal D.P. 2014, Indian Double Taxation Agreements and Tax Laws, 104, (Taxman's Publications 2014)

¹³ *Ibid*

¹⁴ A Resident refers to a person who as per the relevant laws of the Contracting States, i.e. India and the US are liable to pay tax by reason of domicile, residence, citizenship, place of management, place of incorporation, etc.

understand this through “*Round Tripping and Treaty Shopping.*” Shell companies play a major role in Round Tripping. Shell Companies are fictitious companies that don’t have any authentic set-up and are formed only on papers. The reason for making these types of companies is to hide untaxed income or invest black money in them. In this case, the exchequer of the Indian government takes a severe hit and the money that was supposed to be deposited with Indian government goes in wrong hands. So, due to shell companies and tax evasion on part of a person, the rights of the citizens of a nation are severely affected. Treaty shopping happens when a foreign company comes to start its business in India through a tax haven nation. It registers a company the headquarter of which is in a tax haven nation and establishes its subsidiaries in India.

2.4 Money Laundering

Money Laundering is a process through which people make their untaxed money (black money) convert into white. It includes separation of untaxed money from the taxed one and then ultimately mixing the untaxed one later with the money on which taxes were already paid. For e.g. Mr. A is running a business of restaurants and earns a profit of 1 lakh INR every month but he mentions 1.5 lakhs per month in the record books and deposits this 1.5 lakhs in the bank. This mixing of black and white money is called as money laundering.

3. EFFECT ON ECONOMY

As said earlier, black money generation in any economy creates a gap in the economic structure of the country it not only raises inflation in the country, but also prevents government from taking necessary steps for the welfare of its citizens. The black money deposited in tax haven nations fails the plans of the government related to the implementation of welfare programs, policies, etc. Let’s try to discuss the impact of tax evasion and the generation of black money in an economy because a perusal of these points will help us in coming up with potent solutions at large.

3.1 Government fails to implement welfare projects, policies, etc.

The citizens of a nation expect good and implementable policies from their governments because they pay regular taxes. The governments need funds for implementing the policies that were framed by them. But, if there is a large influx of black money in any economy, it will negatively affect the government’s idea of starting welfare programs in the nation. For e.g. if the government decides to chalk out a plan for improving the education, medical or industrial

sector, the money it needs for their development is less as the expenditure of the government on these policies often becomes more than the desired results or the outcomes. The resources that could have been utilized for the welfare of the citizens could not be materialized due to the rampant tax evasion on part of the citizens. The money deposited in Swiss banks, etc. cannot be used for the citizens of a nation at large because once deposited, it is very difficult to bring it back due to the opaque policies of tax haven nations. A nation becomes dependent on international market too much if huge amount of black money is generated in its economy or gets deposited in tax haven nations. Therefore, it is necessary to anyhow stop people from evading their taxes and generating black money in any economy including India's as well.

3.2 Price Rise

Tax Evasion in an economy plays an important role in creating inflation in the market. Inflation occurs due to the increase in the cost price of a commodity. Limited resources force people to go for alternatives. This can be understood from an example like a student goes for tuition classes due to worst teaching and resources in his school. Failure to control the supply of money in an economy by the Central Bank of that country creates inflation and this only due to the large extent of black money generation in the economy. The economic balance of the society takes a severe hit and the rich becomes richer and the poor, becomes poorer. This divide of the society on the financial basis is not good for any economy be it a developed or a developing one.

3.3 Parallel Economy

Parallel economy means running of an illegal sector with the main economy having a tussle with the objectives of the justified and acceptable standards of an economy or of sanctioned sector in the same economy.¹⁵ The black money is generated in such a large amount and its effect is so huge that it appears to be a parallel economy running with the main economy. Mexico can be an example of this where drugs and tax evasion has forced parallel economy to come in. The currency of a nation gets degraded if black money is being used continuously creating a parallel economy and the result is price rate, joblessness, etc. The money generated through parallel economy affects the authentic procedure and forces the governments to take steps against the citizens like raising taxes arbitrarily, increasing the price of the commodities, etc.

¹⁵ Sukanta Sarkar, The Parallel Economy in India: Causes Impact and Government Initiative, *Economic Journal of Development Issues*, 124, 124-125.

3.4 Tarnishing the image of the nation

The image of a country is tarnished if repeated cases of tax evasion are reported from its territory. The businessmen around the world develop a sense of insecurity and are often scared of investing in these countries. The governments of nations hesitate to have business relations with the countries having a huge chunk of black money stored in their economy and IMF and the World Bank are not too sure about helping these nations financially. Economy is the base of every nation and therefore it is necessary for the governments to keep an eye working of tax officials as well as taxpayers because their conduct will decide the reputation of the country at the global level because we are living in a globalized world where almost every nation is dependent upon any other nation for fulfilling its needs and therefore it won't be difficult for any country to know about the internal problems (including tax evasion on part of the citizens) of any country and thereby affecting their relations with each other at the global level.

3.5 Government's deficit gets increased

Government's deficit gets increased due to tax evasion and black money generation in the economy of a country as the funds that were required to be deposited in the government's exchequer finds place in the tax haven nations. Let's try to understand it with the help of a hypothetical example. For e.g. if 5000 rupees were to be deposited as tax to the government by a taxpayer but he decides to deposit only 2000, this deficit of 3000 rupees creates an imbalance in the economy. This may compel the government to go for more borrowings and increase rates of taxes as well.

4. PREVENTIVE MEASURES ARE NECESSARY

The Indian government in December, 2021 failed to provide authentic figure of untaxed money kept by the Indians in tax havens. A rough estimate of Rs. 8644 crores were taxed and 1294 crores in form of penalty were imposed on the people who were considered to be tax defaulters.¹⁶ However, it is presumed that a huge amount of untaxed money of the Indian people is kept in tax haven nations like Switzerland, etc. The Swiss National Bank released its data saying that the Indian's money (in form of black money) has swelled to Rs. 20,700 crores in

¹⁶ No official estimate of black money I foreign accounts in last 5 years: Govt. in Parliament, Times of India News, April 7, 2022, <https://timesofindia.indiatimes.com/business/india-business/no-official-estimation-of-black-money-in-foreign-accounts-in-last-5-years-govt-in-parliament/articleshow/88279663.cms>

the year 2020.¹⁷ This is a serious problem because India is lacking behind on infrastructural development in some sectors like constructing proper schools and hospitals in interior areas including villages, towns, etc. and this problem can be solved through funds which is directly related to the prevention of tax evasion and generation of black money. The government of India has taken some crucial steps in the direction and enacted statutory laws as well. The government has been successful in estimating the disclosures related to undisclosed foreign assets as well under the law enacted in 2015. However, for ensuring transparency, proper implementation of these laws is the need of the hour. There are certain measures that can be adopted to address the problem of black money generation in India's economy and they can be summed up in the following manner:

4.1 Making necessary changes in the taxing system

India, being a democratic country has a system of collecting taxes which allows the government to go for imposing taxes on the citizens. But, if the government through proper strategy decides to implement policies related to reduction of taxes and collection in the most appropriate form, people will find it easy to pay their taxes because low tax rates won't hurt them at all. Hurting here means affecting their pockets. It doesn't mean depriving the government to collect appropriate taxes from the citizens, rather it is something related to collection of taxes in a balanced manner where the tax payers are happy to contribute to the government's account without considering it to be a burden on them.

4.2 Digitalization

In order to create a robust tax collection and record system, the Indian government along with the State governments should make an electronic record for all kinds of transactions and make it mandatory for the parties do go for digital transactions as it helps in creating a record. Cash transactions often go unreported and it is difficult to nab those who use black money in form of cash. Maintaining exact record of cash transactions in a country of more than 140 crore citizens is not that easy and creates difficulty in prosecuting those who are accused of doing illegal transactions. Digitalization removes any kind of opacity in the transactions and creates a record for knowing the details about the person.

¹⁷Indians' funds in Swiss banks climb to Rs. 20,700 crores, highest in 13 years, India Today news, April 12, 2022, <https://www.indiatoday.in/business/story/indian-black-money-swiss-bank-accounts-latest-estimate-1816211-2021-06-17>

4.3 Making agencies stronger

The Income Tax department ensures proper collection of taxes as per the provisions of the Indian Constitution and the Income Tax Act and goes into the details of cases of tax evasion and gives notice to the people who are accused of refraining from paying their taxes in a transparent manner or don't pay at all. The need of the hour is to come up with strong strategies for stopping the officers of Income Tax departments from becoming the puppets of influential personalities. In simple terms, the government should keep a check on the records of the tax defaulters prepared by the IT department and scrutinize it in the best possible manner and for doing this, regular checking by government through its investigative agencies has to be ensured to avoid any kind of nexus between the officials and the tax evaders. At the same time, the government should give free hand to honest officials who have credible information related to tax defaulters or people who are accused of tax evasion for taking action against them within the boundaries of law. This will surely create a sense of terror in the minds of tax defaulters or those who are habitual offenders and have been engaged in evading their taxes over a long period of time creating problems for the country's economy. Strong agencies in any country, through their modus operandi will ensure effective implementation of relevant laws and nabbing tax evaders as well.

4.4 Patch up with nations

The current Indian government has brought various laws on combating the generation of black money in India covering different topics related to it as well.¹⁸ At the same time, the Indian government has asked the governments of various other nations and their banks like Swiss bank, etc. to share the details of the Indians who have evaded taxes in India and deposited their untaxed money in the bank of Switzerland. I think that the government of India pressurize the countries where tax evaders of India keep their money for disclosing the names and making transparent procedure for bringing back the money, so stashed here. Various treaties, conventions, declarations, etc. can be formulated between India where it is easier for bringing back a person who is accused of evading taxes in India and goes abroad for settling purposes.

4.5 Right to Information

In India, there are many political parties that are funded by various NGOs, businessmen, etc. It is important to know about the actual donations that are given to the political parties by these

¹⁸ Dr. Pradip Kumar Das, The Menace of Black Money in India, *Archives of Business Research* 7, 77-87

people and their source as well. This is necessary because it will not only stop the influx of black money in Indian elections but also help in creating a transparent system of regulating spendings by the political parties. The Income Tax department as well as the Enforcement Directorate should be given free hand by the government to inquire about the fundings to different political parties in a course of time and more importantly, it should be made mandatory for every donor to make online or digital transactions while giving donations to political parties. This transparent approach will help in nabbing tax defaulters as well as creating preventive measures for those who have the intention and tendency of evading their taxes.

5. CONCLUSION AND SUGGESTIONS

Our nation, India would have developed a lot if tax evasion and the generation of black money in the country was seriously handled by the governments and the judicial system. This money could have been utilized for creating infrastructural development in India, thereby giving a boost to its economy. The framers of the Indian Constitution wanted to have a country where citizens have access to basic facilities like food, clothing and shelter and at the same time, live with dignity. They were desirous of including the principles of equality and liberty for ensuring the upliftment of citizens. However, some greedy people, just for the sake of their self-interest have failed them by going against the principles of the Indian Constitution. Tax evaders, through their antics shatter the dreams of the founding fathers because the means they adopt are totally illegal and deprive the government from the benefits it should have got. As said earlier, tax evasion, at any level is problematic for any nation. It questions the patriotism of a citizen as he is directly harming the economy. India has a well-oiled organizational structure for collecting taxes and nabbing tax defaulters but the zeal on part of the officials as well as the government to nab tax defaulters is lacking somewhere. In India, it's often seen that corruption on part of the government officials play an important role in giving a shield to the actual offenders. This habit of taking undue advantage by any person, especially the government officials should be addressed at the earliest. It is desirable that the laws that have been enacted to combat the menace of black money generation are properly applied. An example should be set by the government for others showing that anyone who is engaged in tax evasion or the generation of black money in the economy would be severely punished. The government officials and the ministers should be counselled properly and the repercussions of tax evasion should be clearly explained to them by highlighting the cases of nations whose economy has been torn apart due to rampant tax evasion and black money generation. A comparison of India

with least corrupt countries like Denmark, Finland, New Zealand, etc. will give us an impression that these countries have always kept a check on the generation of black money in their economies. India can learn something from these countries and take proper steps for implementing the policies adopted by them. The citizens should be explained the tax laws properly and in a simple manner and they should be taught to save their taxes instead of evading them. India doesn't lack resources and is very much capable of fulfilling the needs of its citizens but for doing so, it is required that transparency is maintained in its internal workings including collection of tax. If this would have been done right from 1950-51, our nation would have been in the list of developed countries because we have some of the excellent brains in the world. But, because of the harmful steps taken by some citizens including politicians, the country still lags behind. The divide of the rich and the poor has widened and it is because of corruption and tax evasion primarily. It is high time when the Indian government should take a bold stand on the generation of black money in India and implement the provisions of laws in a stricter and transparent manner. These steps will not only help in curbing the problem of black money but also create a genuine fear in the minds of people preventing them to take any illegal step in this direction. The sooner it is done, the better it is.

